Tax Credit Review Commission
Economic Development Committee
Amended Committee Report at the Request of the Commission 11-5-10

Pete Levi, Chair
Jim Anderson, Co-Chair

Members:

Senator Jolie Justus
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Tax Credits Assigned:

BUILD
Business Facility
Development Tax Credit
Enhanced Enterprise Zone
Film Tax Credit
MDFB Bond Guarantee
MDFB Infrastructure
Quality Jobs
Incubator Tax Credit
Rolling Stock Tax Credit

Preamble:

Success in economic development today and into the future requires that Missouri focus on three primary strategies: recruiting businesses to the state, incentivizing the expansion and retention of existing businesses, and fostering the growth of business startups. In today's economic development environment, Missouri must be equipped to compete with other states and countries to attract, retain and grow businesses with competitive business development incentives that are easy to understand, promote and utilize, and which complement Missouri's business-friendly environment by providing direct incentives to businesses that create jobs and make capital investments and by providing the financing necessary for the public infrastructure that facilitates business growth.

State tax credits are an important part of Missouri's business development toolkit. Changes in today's economy and the evolution of operations have highlighted areas where Missouri's business development tax credits fall short in providing the most effective means to promote business development, job creation and capital investment. To make the most effective use of Missouri's business development tax credits and the taxpayer dollars they utilize, Missouri's tool kit should contain business development tax credits that:

- Complement and effectuate the strategic objectives developed through the Governor's Strategic Planning Initiative for Economic Growth by targeting high-growth industries to attract, retain and grow in the state
- Incentivize targeted economic activity that would otherwise not occur without the tax credit;
- Give priority to measurable job growth and capital investment; and
- Bear a proportionate relationship to the industry sectors that make up our existing and emerging economic base.

When working to recruit or retain a business prospect, the State will calculate and communicate the available business development tax credits to the prospect in the form of a proposal. In the current economic development climate, a business prospect is often simultaneously considering similar such proposals from competing states (or even countries). This competitive landscape makes it critical for Missouri to be able to present a concrete, streamlined, and easy to understand proposal that can influence business decision-making on a real-time basis.

The ability to provide a concrete proposal, with confidence of the continued existence of the incentive or finance tool, provides the certainty necessary for business decision-making to occur. Tax credits, which are authorized by statute, complement this proposal process. Subjecting Missouri's business development tax credits to an annual appropriations process could severely hamstring Missouri's ability to provide the kind of concrete proposals necessary to attract and retain businesses that will create jobs and make significant capital investment in the state. The General Assembly should establish appropriate criteria in the award of both discretionary and entitlement business development tax credits. The committee hopes that the guiding principles set forth below will aid the General Assembly in that process.

Committee Methodology:

1. Guiding Principles

The Economic Development Committee approached its task by establishing a series of guiding principles related to the use of business development tax credits to promote economic development. The committee then applied these guiding principles to evaluate each of the existing tax credit programs assigned to the committee. The guiding principles adopted by the committee include the following:

- **Positive Return on Investment**
    - o Discretionary business development tax credits offered directly to a business should be used only when the project is projected to provide a positive return on investment, defined as a fiscal benefit to the state General Revenue fund net of the cost of the incentive and measured by a REMI or equivalent model. The amount of this return may vary between programs.
- **Return on Investment Within a Defined Time Period**
    - o The fiscal benefits to the state General Revenue fund should occur within an established time period, not to exceed 10 years, but in no event greater than the term of the benefit. However, discretionary business development tax credits used for public

infrastructure should be allowed a longer period in which to gain a positive return on investment, not to exceed 20 years.

- **Focus on Primary Jobs**
  - Business development tax credits should focus predominantly on “primary” or “base” jobs, which are jobs that produce goods or services in excess of what can be consumed within the local market and thereby bring new money into the local economy.
- **Reward Higher-Paying Jobs With Benefits**
  - Business development tax credits should reward higher paying jobs (above county average wage) with due consideration for location, local employment (recent job loss), job numbers, and company permanency.
  - Business development incentives should reward companies who offer health insurance to their employees.
- **Consider Local Participation**
  - Business development tax credits should consider (and reward) cost sharing with local governments.
- **Flexibility**
  - Business development tax credits should be flexible to meet targeted, high growth industries and sectors, to incent a business activity or close a financing gap, and to apply to a variety of eligible activities, applicants and uses (able to address industry-specific cost pressures).
- **Simplicity**
  - Business development tax credits should be simple to understand, promote and execute and should be streamlined in their operation.
- **Up-Front Financing**
  - Business development tax credits should allow for the option of up-front financing in certain circumstances through the use of refundable tax credits, with defined clawbacks for non-performance.
- **Entitlement and Discretionary Components**
  - Business development tax credits should possess both entitlement and discretionary components, to provide both the certainty offered by an entitlement credit along with the project-specific flexibility offered by a discretionary credit.
- **Broad Applicability**
  - Business development tax credits should work in both urban and rural areas of the state and should be available for large and small businesses.

2. <u>Specific tax credit review and recommendations</u>

Applying the above principles, the committee reviewed each of the assigned tax credits and developed the following recommendations regarding the assigned credits. The first three recommendations address global issues with respect to economic development tax credits. The second series of recommendations (Recommendations 4-13) are program-specific and classify each assigned credit into one of four categories A, B, C, or D. The categories are defined in greater detail in the memorandum submitted to the Commission by Commissioner Van Matre, but are generally as follows: Category A – Retain the credit in its current form; Category B – Modify/improve the credit; Category C – Replace the credit with a grant or appropriation; Category D – Terminate the credit.

Recommendation 14 provides a global framework for improving Missouri's toolkit by replacing the various economic development tax credit programs with one unified economic development tax credit program. The unified program would utilize the same pool of funding represented by the existing program caps, and therefore would not result in any additional cost the State, while at the same time would more effectively promote the guiding principles identified by the committee as being necessary to create jobs and promote capital investment in the state.

Recommendation 15 establishes a new Angel Tax Credit Program to address the financing gap that serves as an obstacle to growing new businesses in the State. The new program would utilize the existing cap on the Film Tax Credit ($4.5 million).

Recommendation #1
The Committee recommends that Missouri's business development toolkit contain programs that:

- Complement and effectuate the strategic objectives developed through the Governor's Strategic Planning Initiative for Economic Growth by targeting high-growth industries to attract, retain and grow in the state
- Incentivize targeted economic activity that would otherwise not occur without the tax credit;
- Give priority to measurable job growth and capital investment; and
- Bear a proportionate relationship to the industry sectors that make up our existing and emerging economic base.

Recommendation #2
The Committee recommends the Commission adopt the Preamble to this report and the Guiding Principles listed above to use in the evaluation and recommendation of tax credits related to business development.

Recommendation #3
The Committee recommends business development tax credits not be made subject to the appropriations process.

In order to support classifications of the assigned credits into one of the categories identified in Commissioner Van Matre's memorandum, the committee compared the attributes of the existing programs to the guiding principles developed by the committee. The existing programs were then assigned a ranking (High, Medium or Low) to reflect how consistent each program is with the guiding principles and assigned to one of the four categories outline in Commissioner Van Matre's memorandum.

Program	Rank	Category	Recommendations
BUILD	High	B	**Recommendation #4** - The committee recommends that the General Assembly lower the minimum thresholds for eligibility and participation in the BUILD Program to 250 jobs (from 500 jobs) or 150 jobs (from 250 new jobs) in Distressed Areas for Office Projects and 75 new jobs (from 100 new jobs) for Manufacturers to enable a greater number of businesses to take advantage of the program.
MDFB Bond	High	B	**Recommendation #5** - The committee recommends that the

Guarantee			General Assembly lower the cap from $50M to $40M to more accurately reflect the usage.
Quality Jobs	High	B	**Recommendation #6** - The committee recommends that the General Assembly amend the program to include a discretionary component (an additional tax credit awarded calculated as a percentage of total new payroll) that would allow for the direction of funding to targeted industries and allow for the option of up front financing in certain cases. This up-front financing may be accomplished through the award, by contract with the recipient, refundable tax credits in the first year, with a clawback and performance benchmarks, rather than as opposed to providing tax credits over time based upon performance. The total annual amount of up front tax credits that may be awarded should be limited by statute to ensure budget certainty and would be reduced from the programs' existing annual cap. Amend to lower the current job thresholds to 10 jobs for a period of not more than 3 years in order to promote economic recovery and increase job growth. Amend to include a tax credit benefit to allow for certain levels of capital investment that occurs in the state by creating a tax credit awarded based on a percentage of total new capital investment.
Enhanced Enterprise Zone	High	B	**Recommendation #7** – The committee recommends amending the program to include a discretionary option for up-front financing in certain cases. This up-front financing could be accomplished in the same manner as stated in Recommendation #6 through the award, by contract with the recipient, refundable tax credits in the first year, with a clawback and performance benchmarks, rather than as opposed to providing tax credits over time based upon performance. The total annual amount of up front tax credits that may be awarded should be limited by statute to ensure budget certainty and would be reduced from the programs' existing annual cap. Consider amending to provide a more flexible definition of distressed communities that would include extreme situations of blight and economic obsolescence.
MDFB Infrastructure	Medium	B	**Recommendation #8** - The committee recommends requesting that the MDFB evaluate and consider administrative changes to make the program operate more efficiently and maximize return on investment consistent with the Guiding Principles adopted for economic development tax credits.
Incubator Tax Credit	Medium	C	**Recommendation #9** The certified incubators that use this tax credit could be more effectively funded through a grant program based on an annual appropriation process. The current $500,000 cap, when divided up among all of the certified incubators around the state, fails to provide sufficient efficiencies of scale to operate a contribution tax credit

			program. In place of the credit, funding for a grant program could be appropriated to the Missouri Technology Corporation for award and distribution in a manner similar to the existing process for funding Innovation Centers and other similar state and federally-funded programs. Any proposed grant program should also include a required match in order to maintain the private match currently enabled by the tax credit.
Development Tax Credit	Medium	B	**Recommendation #10** - The tax credit uses a cumbersome process requiring a non-profit to actually hold title to equipment purchased by a business and then lease it back to the business. The General Assembly should create a more efficient design that retains the discretionary component of the credit for helping to offset equipment purchases and upgrades and is specifically targeted at the retention of Missouri businesses. Additional changes could include allowing additional benefits for higher paying jobs with health benefits, requiring proof of either a long-term lease or minimum amount of private capital investment, and rewarding companies with a significant likelihood for additional expansion. Simplifying the process would help to eliminate unnecessary transaction costs and thereby provide a greater benefit to companies for the same cost to the state.
Business Facility	Medium	B	**Recommendation #11** - The current credit is too narrow in its focus and too limited in its eligibility requirements to be broadly utilized to attract and retain jobs and capital investment. The committee recommends the eligibility requirements should be expanded to include additional targeted industries and should allow greater flexibility to calibrate the amount of benefits based on the jobs created, capital investment, and overall return to the state. The credit could also be modified to allow for an incentive based on capital investment alone.
Film Tax Credit	Low	D	**Recommendation #12** - This tax credit serves an industry that creates short term positive impacts at the local level, but that fails to provide a positive return on investment to the state. The committee recommends that the General Assembly amend the credit by maintaining its use as a funding mechanism for films, but limiting the availability of the credit to circumstances where the local jurisdiction will agree to forgo the amount of the credit offered from the locality's distribution of local taxes collected by the state. Under such a program, the local jurisdiction would fully reimburse the state for every film tax credit project approved by the state at the request of the city would be fully reimbursed by the benefitting locality. Accordingly, the tax credit, although awarded to a film company, would only serve as a short-term loan from the state, to be re-paid to the state by the local jurisdiction.

Rolling Stock	Low	D	**Recommendation #13** – The Committee recommends that this tax credit be eliminated. This tax credit serves too narrow of an industry and fails to require a positive return on investment to the state.

Recommendation #14

The committee has also developed a global recommendation for improving Missouri's toolkit by replacing various economic development tax credit programs with one flexible, unified program. This unified program could utilize the same pool of funding represented by the existing program caps (and potentially other programs currently under review by other committees), while at the same time better effectuating the guiding principles identified by the committee as being necessary to create jobs and promote capital investment in the state. The combined annual cap of the new unified economic development program should be a function of the total existing program caps, with due consideration of a reduction of that annual cap equal to any amounts currently obligated for each future year, and reflective of the actual average maximums obligated.

Specifically, the committee recommends that the General Assembly adopt a unified economic development credit that follows the guiding principles to replace the existing BUILD, Enhanced Enterprise Zone, and Missouri Quality Jobs Programs. As discussed in greater detail above, these guiding principles include:

- Positive Return on Investment
- Return on Investment Within a Defined Time Period
- Focus on Primary Jobs
- Reward Higher-Paying Jobs With Benefits
- Consider Local Participation
- Flexibility
- Simplicity
- Up-Front Financing
- Entitlement and Discretionary Components
- Broad Applicability

The features of this unified credit would include:

- Provides for both a retention of withholding taxes and a refundable tax credit by an eligible company
- Includes an entitlement base benefit similar to Quality Jobs using withholding taxes, with an additional discretionary benefit in the form of refundable tax credits, based on the amount of positive return on investment for the state, the amount of local participation, the level of competition with other states, or the existence of a proven gap financing
- Creates an established annual statutory cap, which reflects the reduction of any obligations under current programs
- Allows for "up front" financing to be accomplished by allowing the award of refundable tax credits to a company in the first year, with a contract, complete with clawbacks and benchmarks. A maximum annual amount of up-front refundable credits should be specified in statute to provide budget certainty, and the award of any up-front credits should be counted against the program's overall annual cap.
- Provides an additional discretionary benefit for targeted industries identified in the Governor's Strategic Planning Initiative for Economic Growth.
- Provides limits on "stacking" other state incentives

- Provides the benefit based on both new jobs to the State (jobs at the facility over and above the number of jobs in Missouri working at the same company at all facilities in the 12 months previous) and capital investment made in the state.
- Creates a requirement that any discretionary tax credit awards be subject to a positive return on investment over a fixed period of time
- Includes company eligibility criteria similar to the current Missouri Quality Jobs program (benchmark number of jobs, benchmark amount of investment, wage amounts and health insurance), but is flexible enough to be utilized by large and small businesses and in rural and urban areas
- Creates a priority for companies with a majority of their business in interstate commerce, like in the current EEZ and BUILD programs
- Requires a financial "but-for" requirement similar to that in the current BUILD program, whereby the project would need to demonstrate that without state assistance to fill a financing gap, the project would otherwise not occur.
- Provides that any obligations incurred by the state under existing tax credit programs would continue and would be honored for the full term of their award.

Recommendation #15

The third recommendation establishes a new Angel Tax Credit Program to address the financing gap that serves as an obstacle to growing new businesses in the State. Under this program, the Department of Economic Development could authorize tax credits to encourage equity investment in technology-based early stage Missouri companies, commonly referred to as angel investments. Investors who contribute a benchmark amount in equity investment to a qualified Missouri business may be issued a tax credit equal to an established percent of the investment or a higher percent of the investment if the qualified business is located in a rural area or distressed community. To create this new program while remaining revenue-neutral, it is recommended that the existing cap on the Film Tax Credit ($4.5 million) be utilized.